

Message Text

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SUBJECT: CREDIT EXPANSION TO STIMULATE ECONOMY AND EXPORTS

1. SUMMARY: AT END 1977, PRESIDENT SUHARTO APPROVED SIGNIFICANT CREDIT POLICY CHANGES DESIGNED PRIMARILY TO STIMULATE THE ECONOMY, ENCOURAGE INVESTMENT AND BOOST EXPORTS. THE POLICY CHANGES ANNOUNCED ARE PROBABLY MOST-SWEEPING SINCE MARCH 1974 AND INCLUDE (A) REDUCTIONS IN BOTH LENDING AND DEPOSIT RATES, (B) ESTABLISHMENT OF 3-6 MONTH USANCE CREDITS FOR CERTAIN CATEGORIES OF EXPORTS AND BASIC MATERIALS IMPORTS, AND (C) LOWERING OF RESERVE REQUIREMENT FOR BANKS. END SUMMARY.

2. IN MAJOR MOVE AT END OF 1977, PRESIDENT SUHARTO APPROVED IMPORTANT CHANGES AFFECTING AVAILABILITY OF CREDIT. INCLUDED AMONG CHANGES ANNOUNCED DECEMBER 30 WERE MEASURES
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LOWERING BOTH LENDING AND DEPOSIT RATES FOR STATE BANKS.

(A) LENDING RATES VARY DEPENDING ON THE PURPOSES FOR WHICH CREDITS ARE TO BE USED AND THE RELATIVE PRIORITY ASSIGNED TO SUCH USE. FORMULA FOR LENDING RATES IS COMPLICATED ONE WITH SIX MAJOR CATEGORIES OF PRIORITY. RATES IN PAST RANGED FROM 9 PERCENT TO 24 PERCENT. ALTHOUGH UNDER RECENTLY ANNOUNCED CHANGES 9 PERCENT CATEGORY WILL REMAIN

THE SAME, ALL OTHER CATEGORIES WILL BE REDUCED BY AT LEAST 3 PERCENT AND, IN SOME FEW CASES, BY AS MUCH AS 12 PERCENT. REPAYMENT TERMS FOR SOME LOANS HAVE ALSO BEEN EXTENDED FROM 5 YEARS WITH 3 YEARS GRACE TO 10 YEARS WITH 4 YEARS GRACE. GOI HOPES THESE CHANGES WILL SPUR INVESTMENT AND, BY LOWERING COST OF CAPITAL, HELP TO MAKE PRODUCTION COSTS MORE COMPETITIVE WITH IMPORTED GOODS.

(B) DEPOSIT RATES HAVE ALSO BEEN ADJUSTED DOWNWARD. INTEREST RATES ON TWO-YEAR TIME DEPOSITS, THE MAXIMUM AVAILABLE MATURITY AND THE CATEGORY ACCOUNTING FOR ABOUT 85 PERCENT OF TOTAL TIME DEPOSITS WITH STATE BANKS, WERE LOWERED FROM 18 TO 15 PERCENT ON DEPOSITS UP TO \$6000; ON DEPOSITS OVER THAT AMOUNT THE INTEREST IS 12 PERCENT. OTHER TIME DEPOSIT RATES ALSO LOWERED. THIS IS SECOND SIGNIFICANT REDUCTION IN DEPOSIT RATES THIS YEAR. IN 1976, FOR EXAMPLE, 24-MONTH TIME DEPOSITS EARNED 24 PERCENT INTEREST. LOWER DEPOSIT RATE REFLECTS SLOWING OF RATE OF INFLATION (ABOUT 11 PERCENT IN 1977 AS COMPARED TO 14.2 PERCENT IN 1976) AND GOVERNMENT'S DESIRE STIMULATE FLEDGLING CAPITAL MARKET WHOSE STOCK OFFERS ARE NOT ABLE TO COMPETE AGAINST HIGH EARNINGS AVAILABLE FROM TIME DEPOSITS.

3. BANK INDONESIA HAS ALSO DECIDED TO PROVIDE UP TO LIMITED OFFICIAL USE

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6-MONTH CREDIT (THROUGH SO-CALLED USUANCE L/C'S) FOR CERTAIN IMPORTS AND EXPORTS. LISTS OF ITEMS THAT WILL BENEFIT FROM THESE CREDITS STILL BEING DRAWN UP BUT GOI HAS ANNOUNCED THEY WILL BE FOR INDONESIAN EXPORTS WHICH ARE IN WEAK MARKET POSITION AND NEED PROMOTIONAL BOOST AND FOR IMPORTS OF SPECIFIED RAW MATERIALS, "AUXILIARY" MATERIALS AND SPARE PARTS FOR INDONESIAN MANUFACTURES. NEW EXPORT CREDITS WILL HELP TO MAKE SOME INDONESIAN PRODUCTS MORE COMPETITIVE ON WORLD MARKET WHILE IMPORT CREDITS WILL HELP REDUCE WORKING CAPITAL REQUIREMENTS AND HENCE COSTS OF LOCAL MANUFACTURING PLANTS, MANY OF WHOM WERE HURT LAST YEAR BY ABOLITION OF MERCHANT L/C'S.

4. IN FURTHER BOLD MOVE, BANK INDONESIA HAS LOWERED RESERVE REQUIREMENT ON DEMAND DEPOSITS FROM 30 PERCENT TO 15 PERCENT. (THIS MOVE CREATES ANOMALY OF LOWER RESERVE RATIO FOR DEMAND DEPOSITS THAN FOR TIME DEPOSITS FOR WHICH RESERVE RATIO REMAINED AT 20 PERCENT. PRE-SUMABLY, BANK INDONESIA WILL CORRECT THIS SHORTLY.) LOWERING OF RESERVE REQUIREMENT WILL SIGNIFICANTLY INCREASE BANKING SYSTEM LIQUIDITY AND, GOI HOPES, MAKE ADDITIONAL CAPITAL AVAILABLE FOR INVESTMENT WHICH HAS

BEEN LACKLUSTER PAST TWO YEARS. BEFORE IT CAN HAVE THIS EFFECT, HOWEVER, BANK INDONESIA WILL HAVE TO INCREASE BANK CREDIT CEILINGS WHICH NORMALLY ARE SET ANNUALLY IN MARCH. THIS YEAR THAT DATE MAY BE ADVANCED.

5. COMMENT: CHANGES IN CREDIT POLICY ARE THE MOST SWEEPING OF ANY SINCE 1974 AND MARK IMPORTANT SHIFT IN POLICY EMPHASIS AWAY FROM TOUGH AUSTERITY MEASURES DESIGNED TO DEAL WITH PERTAMINA CRISIS AND TO CONTROL INFLATION AND TOWARD MEASURES INTENDED TO STIMULATE ECONOMY, ENCOURAGE INVESTMENT AND BOOST EXPORTS. CREATION OF USANCE CREDITS, ONLY AVAILABLE PREVIOUSLY FOR RECENT FERTILIZER EXPORTS, SHOULD HAVE IMMEDIATE AND SALUTARY EFFECT. IMPACT OF OTHER MEASURES, IN SHORT TERM AT LEAST, LIMITED OFFICIAL USE

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IS MORE DIFFICULT TO GUAGE AND MUCH WILL DEPEND ON HOW CREDIT CEILINGS ARE MANIPULTED, CEILINGS APPARENTLY WILL BE THE MECHANISM BANK INDONESIA WILL USE TO DETERMINE CREDIT EXPANSION AND CONTROL INFLATIONARY INFLUENCE OF MORE LIBERAL MONETARY POLICIES.
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